

Beyond Overdraft:

Helping Consumers Manage Liquidity



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COMMISSIONED BY



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EXECUTIVE SUMMARY

Overdraft fees are frequently criticized as unfair to lower-income consumers, but it's important to remember that they also protect consumers and facilitate commerce. If regulators truly want to be consumer-friendly, they should be monitoring how frequently transactions are returned or declined—when checks bounce or debit card transactions don't go through—because a returned or declined item harms the entire payments channel, from consumer to bank to merchant.

The recent trend to move away from overdraft fees comes at a time when financial institutions (FIs) are experiencing a “revenue recession.” Noninterest income has declined to roughly 25% of the average FI's revenue since the Durbin amendment cut debit card interchange income. That trend has hastened the decline of free checking, surely a consumer-friendly offering.

If FIs are no longer able to collect overdraft fees, unintended consequences may result for:

- **Consumers.** If FIs refuse payments when there are insufficient funds, consumers will be charged returned-payment penalties from the merchant—fees that are frequently higher than overdraft fees—and suffer negative credit score consequences.
- **Financial institutions.** Abandoning overdrafts would hurt FIs, as well, by diminishing noninterest income and leading to charge-offs for delinquent payments. That could result in more pressure on small FIs' branch networks to consolidate, an outcome that neither FIs nor consumers would welcome.
- **Merchants.** Merchants, as well, would lose out if there was a strong regulatory push to curb overdraft fees. Returned payments are costly and cumbersome for merchants, particularly smaller vendors who lack the staff to handle a large volume of refused payments. A significant increase in payment returns could also compel merchants to offset the higher risk of returns with higher consumer prices.

One size rarely fits all, and that's as true for overdrafts as it is for regulatory proposals. FIs must decide how to complete transactions while considering a consumer's ability to pay, the potential losses from fraud and theft, and the underwriting requirements that they must maintain.

With these realities in mind, there are important consumer-friendly practices that FIs can put into place that can ease the sting of overdraft fees. FIs can adjust how much they charge in overdraft fees, establish a daily maximum of fees they will charge, institute proactive balance alerts, make financial education readily available and more.

ABOUT THIS REPORT

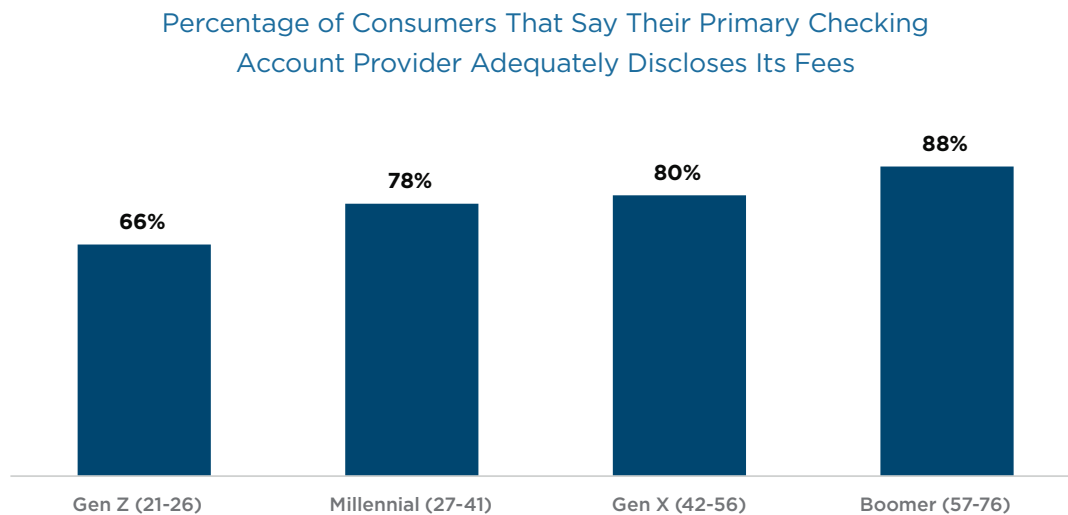
This leaves FIs with strategic decisions regarding the delivery of deposit and credit services and how to price those services. To help make those decisions, this report—based on a Q2 2022 online survey of 3,000 U.S. consumers (representative of the overall U.S. population in terms of age, gender, and race)—explores consumers' use of, and experiences with, overdraft protection services and with overdraft activity on their checking accounts.

THE HIDDEN FEE FALLACY

A Google search on the term “hidden bank fees” produces more than 80 million results. Newspapers like USA Today and newcomer challenger banks highlight the term to draw attention to their articles or offerings. Is it really the problem they make it out to be? No.

Eight in 10 Americans say that their primary checking account provider adequately discloses its fees to them. There are differences by age group, suggesting that over time, as consumers become more experienced in the world of financial services, they learn more about existing fees and understand that they’re not really “hidden” (Figure 1).

FIGURE 1: Adequate Disclosure of Fees



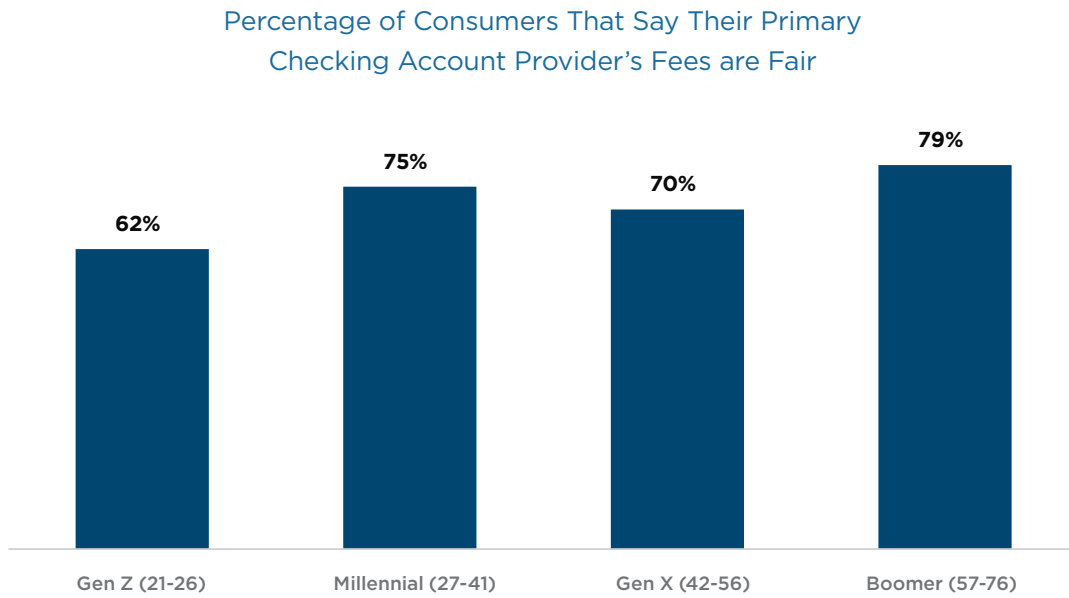
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

This gets overlooked or told a different way in the press and by the Consumer Financial Protection Bureau (CFPB). The CFPB has been working for years on additional disclosure requirements for banks, thinking that rational people would never use overdraft so, therefore, their banks must be withholding information. The survey data doesn’t back up that thinking.

And for all the press and attention being paid to checking account fees, three-quarters of Americans believe that their primary checking account provider’s fees are fair, ranging from six in 10 Gen Zers to eight in 10 Baby Boomers (Figure 2).

FIGURE 2: Fee Fairness Perception



22-1005-02

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Among the common types of fees that consumers pay to banks are overdraft protection fees and overdraft/NSF (non-sufficient funds) charges. The next two sections will explore consumers' use of and experiences with overdraft protection and the overdraft activity.

OVERDRAFT PROTECTION

Nearly six in 10 Americans have overdraft protection on their checking accounts, with 28% saying they don't and 15% not sure whether they do or not (Figure 3). Among consumers with overdraft protection, 60% have opted-in to overdraft protection for everyday debit card and ATM transactions and 84% of them believe having overdraft protection is a good thing.

FIGURE 3: Overdraft Protection Adoption

Do you have overdraft protection on your primary checking account?



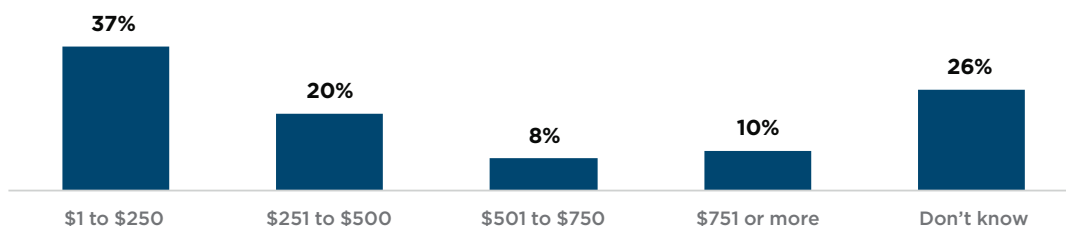
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Among Gen Zers, Millennials, and Gen Xers (ages 21 to 56), 40% who have overdraft protection pay for it—among Baby Boomers, that percentage drops to 18%. Overall, nearly 40% of overdraft protection enrollees have an overdraft limit of up to \$250 on their accounts, with one in five reporting a limit between \$250 and \$500. A quarter of consumers with overdraft protection don't know what their limit is (Figure 4).

FIGURE 4: Overdraft Protection Limits

How much is your overdraft protection limit (in other words, how much will your bank cover if you overdraw your account)?



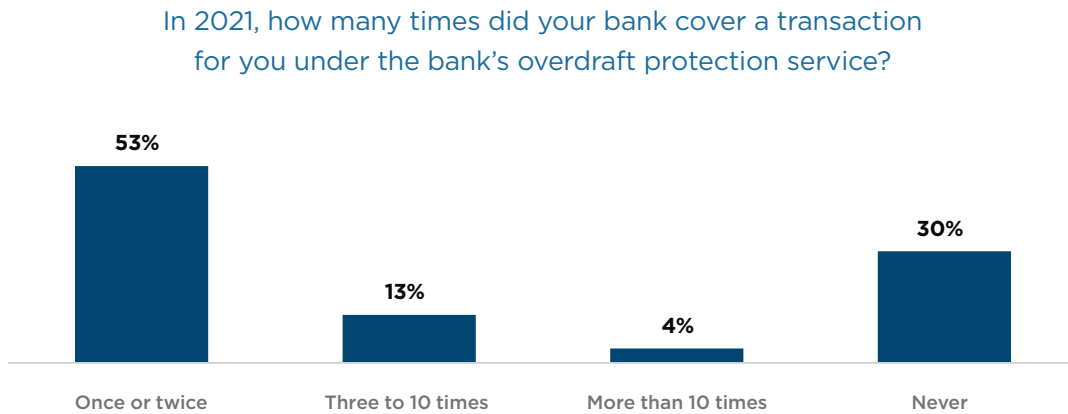
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

CONSUMERS' USE OF OVERDRAFT PROTECTION

Seven in 10 overdraft protection enrollees made use of the service at least once in 2021, with a little more than half needing the service just once or twice (Figure 5).

FIGURE 5: Overdraft Protection Use

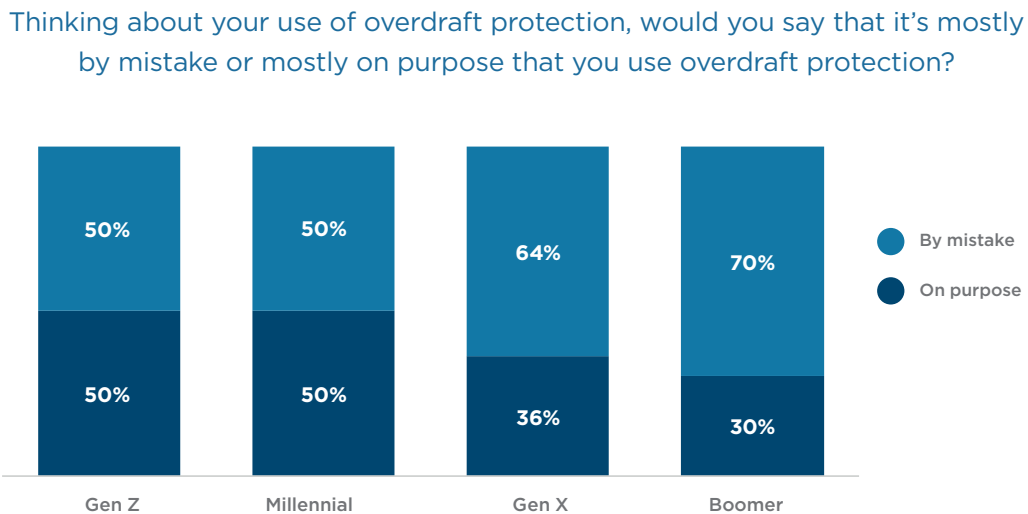


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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Gen Zers and Millennials were evenly split by those that used overdraft protection on purpose versus those that used it by mistake (Figure 6). This finding runs counter to the CFPB narrative that people are tricked into using overdraft or are just making a mistake.

FIGURE 6: Overdraft Protection: On Purpose or By Mistake?



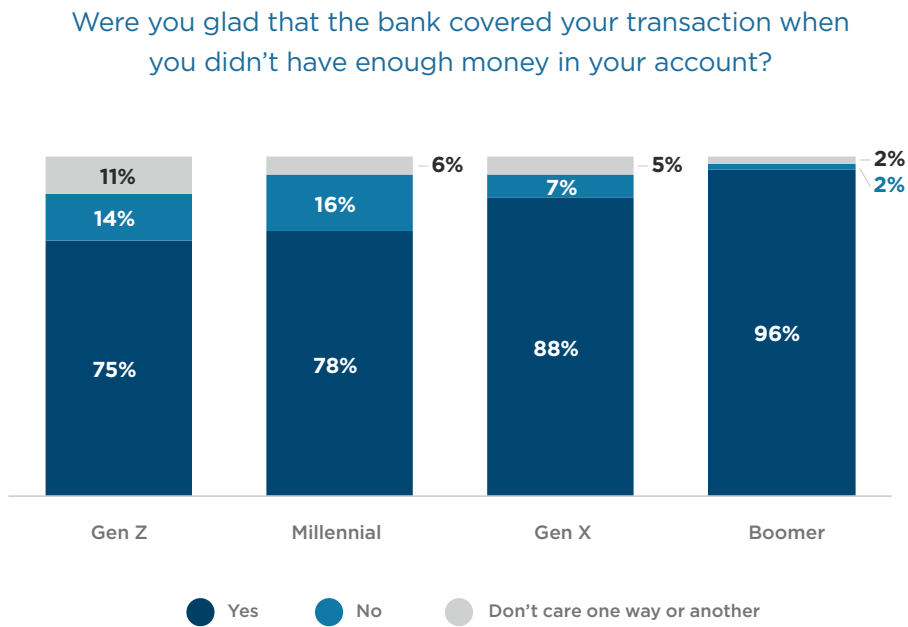
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

CONSUMERS' SATISFACTION WITH OVERDRAFT PROTECTION

Nearly every Baby Boomer, and almost nine in 10 Gen Xers, said they were glad that their checking account provider covered a transaction when there wasn't enough money in the account. Roughly one in nine Gen Zers said they didn't care one way or another, a response we find a bit perplexing. (Figure 7).

FIGURE 7: Overdraft Protection Satisfaction



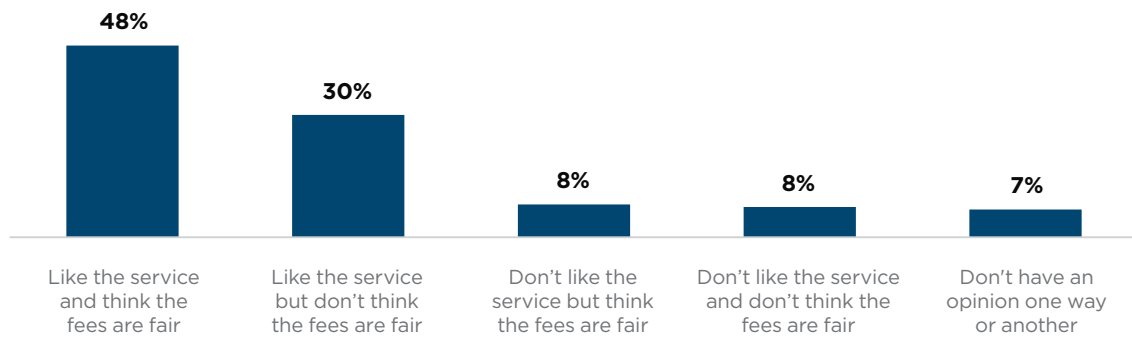
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

While many overdraft protection users were glad their bank covered their payment(s), only about half say that they like the service and think the fees are fair. Three in 10 like the service but don't believe the fees are fair (Figure 8).

FIGURE 8: Overdraft Protection Service Perceptions

How do you feel about your bank's overdraft protection service and its fees?



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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

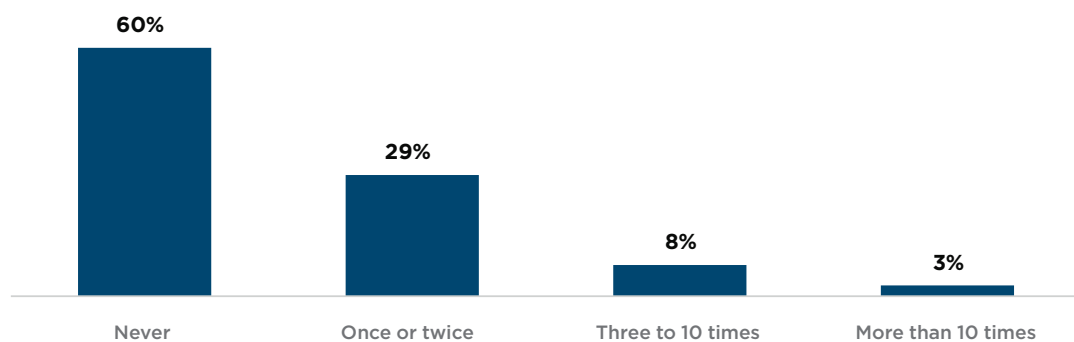
Overall, less than one in 10 consumers don't like their overdraft service and think the fees aren't fair.

CONSUMERS' OVERDRAFT EXPERIENCE

The media often conveys the idea that there is an overdraft epidemic among Americans. The survey results don't support this view. Just 40% of checking account holders overdrew on their checking accounts in 2021 and about three-quarters of those that did overdrew just once or twice (Figure 9).

FIGURE 9: Overdraft Activity

In 2021, how many times did you overdraw on your checking account?



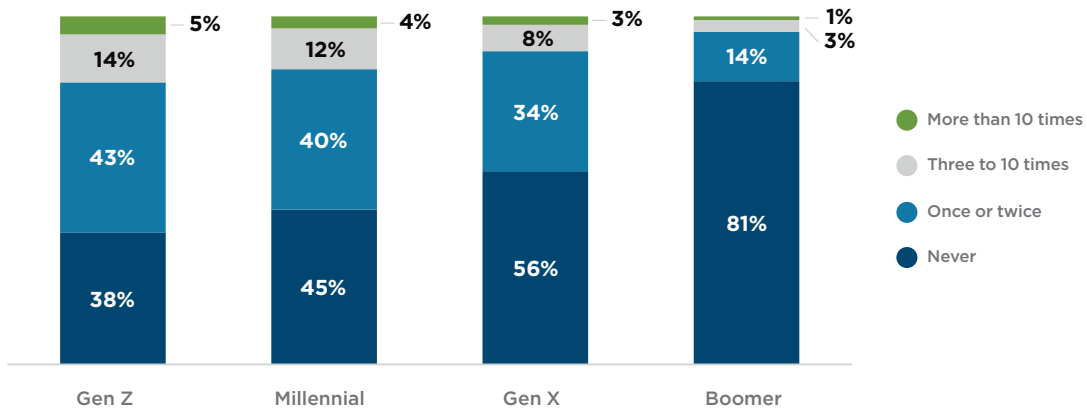
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

The problem is more acute among younger consumers, however. Roughly six in 10 Gen Zers overdrew on their checking account in 2021, as did 56% of Millennials. Among Gen Zers, nearly one in five overdrew three or more times (Figure 10).

FIGURE 10: Overdraft Activity by Generation

In 2021, how many times did you overdraw on your checking account?



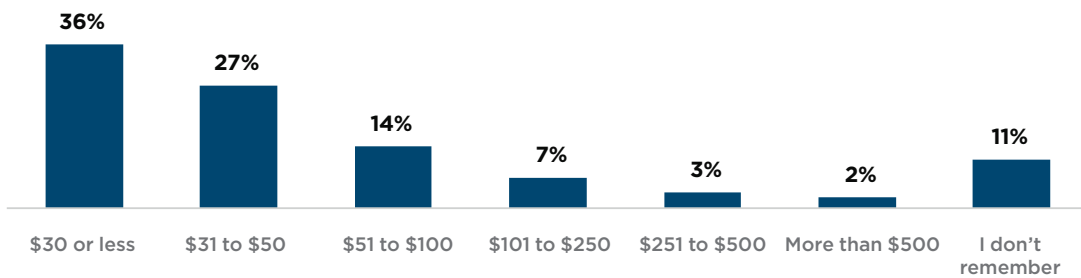
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Among consumers who paid overdraft or NSF fees in 2021, more than three-quarters (77%) paid less than \$100 in total charges (Figure 11).

FIGURE 11: Overdraft Payments

In 2021, how much were you charged by your bank(s) for overdraft and NSF fees?



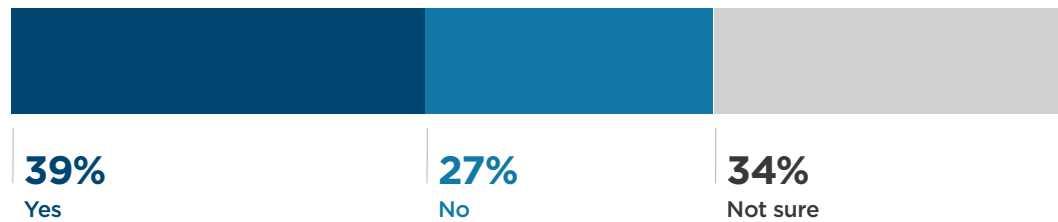
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Among consumers who paid an overdraft or NSF fee in 2021, just four in 10 think the fee is fair. To emphasize the need for more education regarding these charges, a third of overdraft/NSF fee payers said they weren't sure if the fees they were charged were fair (Figure 12).

FIGURE 12: Fairness of Overdraft and NSF Fees

NSF fees are charged when the bank returns (doesn't pay) an item for you and overdraft fees are paid when the bank does pay an item for you. Do you think your bank's overdraft and NSF fees are fair?

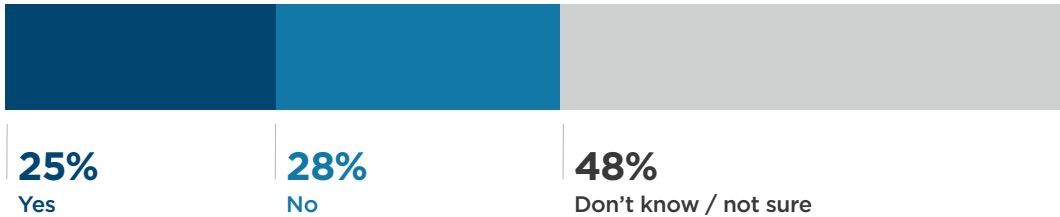


OVERDRAFT POLICY CHANGES

As mentioned earlier, many financial institutions have changed their overdraft policies over the past year. Have consumers taken notice? Just one in four consumers said their primary checking account provider has changed its overdraft fee policy (Figure 13).

FIGURE 13: Change in Overdraft Policies

Many banks have eliminated or reduced their overdraft fees. Did the bank you have your primary checking account with reduce or eliminate its overdraft fees?



22-1005-13

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

The “don’t knows” and “not sures” are driven by older consumers, however. Six in 10 Baby Boomers are unsure if their primary checking provider has changed its overdraft policy. There are a little more than a third of Gen Zers and Millennials who don’t know if their bank or credit union has changed its policies, but a third of both groups say their primary checking account provider has changed its policies (Table A).

TABLE A: Change in Overdraft Policies by Generation

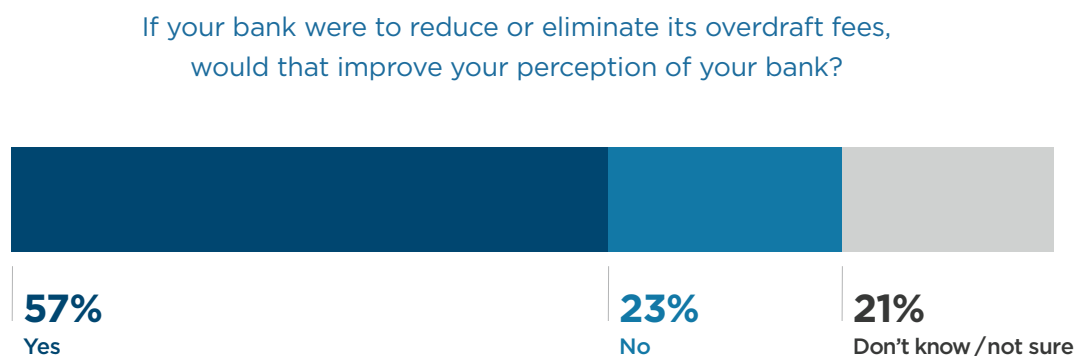
Did the bank you have your primary checking account with reduce or eliminate its overdraft fees?

	Gen Z	Millennial	Gen X	Boomer
Yes	34%	34%	27%	15%
No	30%	30%	31%	24%
Don't know/not sure	36%	36%	42%	62%

Source: Cornerstone Advisors surveys of 3,000 US consumers, Q2 2022

If institutions that haven't changed their overdraft policies are wondering if doing so would have an impact on their consumers' perceptions of the institution, the data is inconclusive. Just over half (57%) of consumers said a reduction or elimination of their bank's overdraft fees would improve their perception of the institution, but 44% said it wouldn't or that they weren't sure that it would (Figure 14).

FIGURE 14: Potential Impact of Change in Overdraft Policies



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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

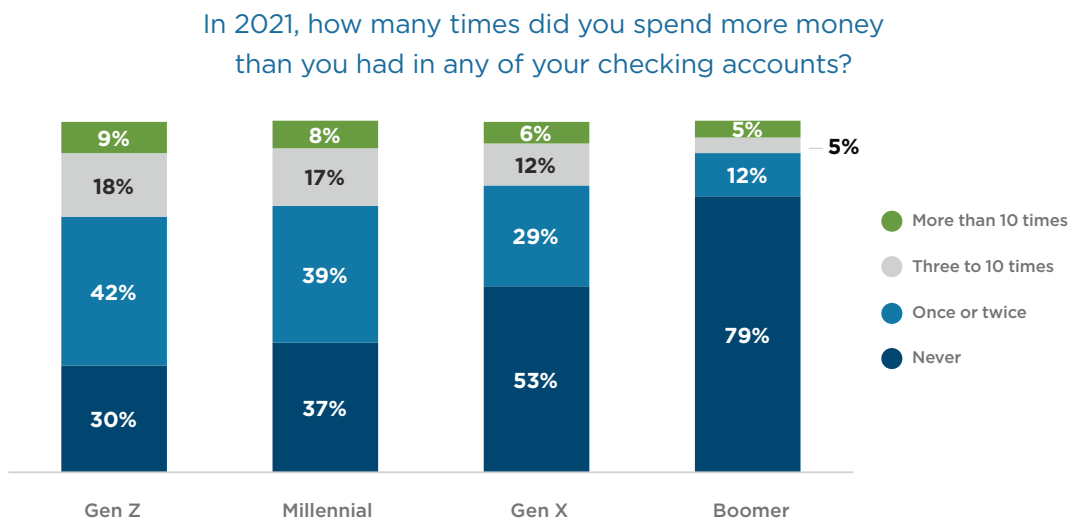
The overdraft issue is mainly being heard in the financial industry echo chamber instead of in the world at large, with over a half of respondents saying they had not seen any news about overdraft protection. Interestingly, only 12% of survey respondents said that any news they had seen left them with a more negative opinion about overdraft.

Why make drastic changes if people don't have a substantial negative opinion of overdraft?

CONSUMERS' LIQUIDITY MANAGEMENT CHALLENGES

Overdraft protections, overdrafts, and NSF's are all results of consumers' liquidity challenges. In 2021, many consumers—particularly Gen Zers and Millennials—experienced liquidity issues. Among both generations, roughly a quarter spent more money than they had in their checking accounts three or more times and about four in 10 spent more than they had at least once (Figure 15). In addition, roughly three in 10 Gen Zers and Millennials said they had trouble paying their monthly bill nearly every month.

FIGURE 15: Consumers' Liquidity Problems

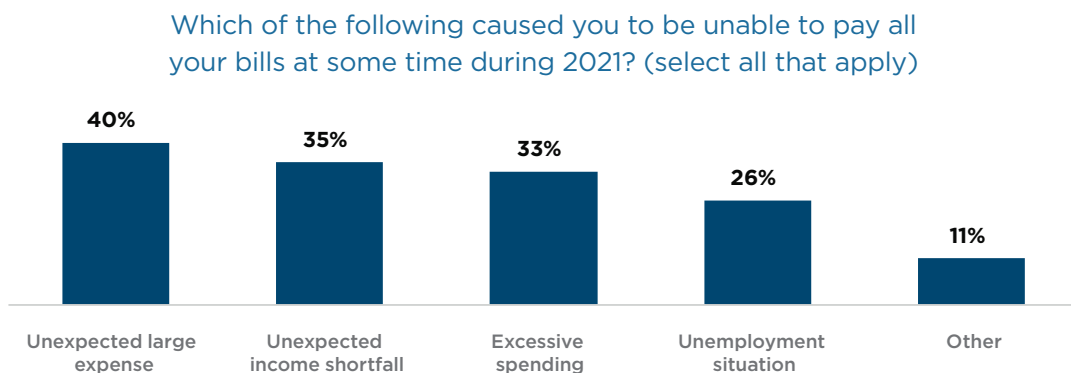


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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

While there are many causes for consumers' liquidity challenges, two reasons stand out—unexpected large expenses, and unexpected income shortfalls (Figure 16).

FIGURE 16: Causes of Liquidity Problems



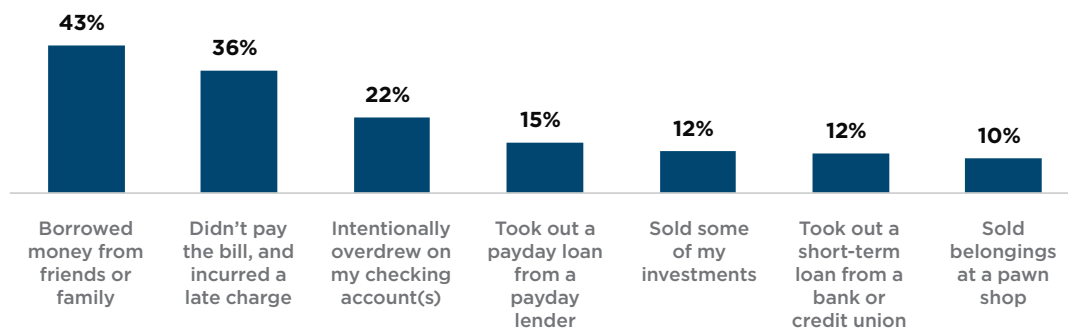
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

And while there are many actions that consumers took when they encountered liquidity challenges, two stand out—borrowing money from family or friends, and not paying the bill (Figure 17).

FIGURE 17: What Consumers Did When They Had Liquidity Problems

When you found yourself unable to pay a monthly bill in 2021, which of the following did you do? (select all that apply)



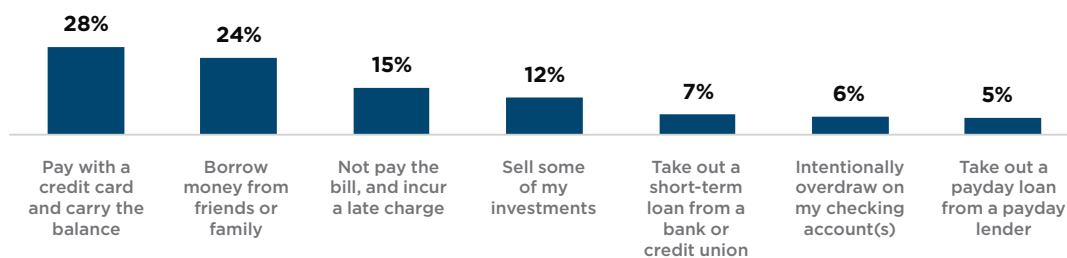
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

If faced with a liquidity challenge next month, the first thing 28% of consumers would do is pay the bill with a credit card and carry a balance. Almost as many consumers—24%—said they would borrow money from friends or family (Figure 18).

FIGURE 18: What Consumers Would Do First If They Had a Liquidity Problem

If you found yourself unable to pay next month's bills, which of the following would you do first? (select one)

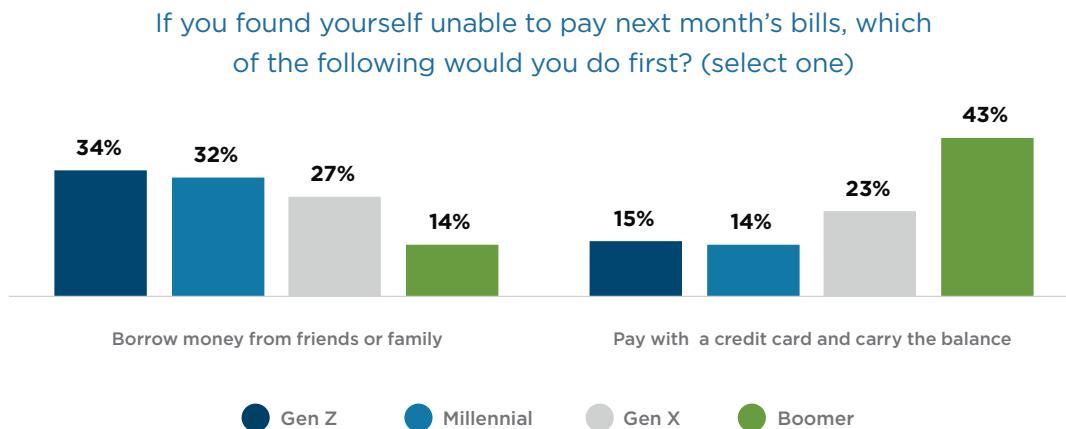


22-1005-18

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

There are substantial differences between the generations, however, regarding what they would do first if faced with a liquidity challenge. A third of Gen Zers and Millennials would borrow from family or friends while 43% of Boomers would pay with a credit card and carry the balance (Figure 19).

FIGURE 19: First Liquidity Challenge by Generation



22-1005-19

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

What if their bank stopped offering overdraft protection? Would that change things? Four in 10 Gen Zers and Millennials would turn first to family and friends if faced with a liquidity problem, with one in five taking out a payday loan. Among Gen Xers and Baby Boomers, the most popular action would be to take the late charge on the bill (Table B).

TABLE B: First Liquidity Challenge Action If Bank Discontinued Overdraft Protection by Generation

If your bank stopped offering its overdraft protection service, which of the following would you do first if you were unable to pay a bill? (select one)

	Gen Z	Millennial	Gen X	Boomer
Borrow money from friends or family	41%	39%	29%	28%
Take out a payday loan from a payday lender	19%	21%	23%	0%
Not pay the bill, and incur a late charge	17%	24%	36%	38%
Take out a short-term loan from a bank or credit union	14%	10%	10%	19%
Sell belongings at a pawn shop	10%	3%	3%	6%

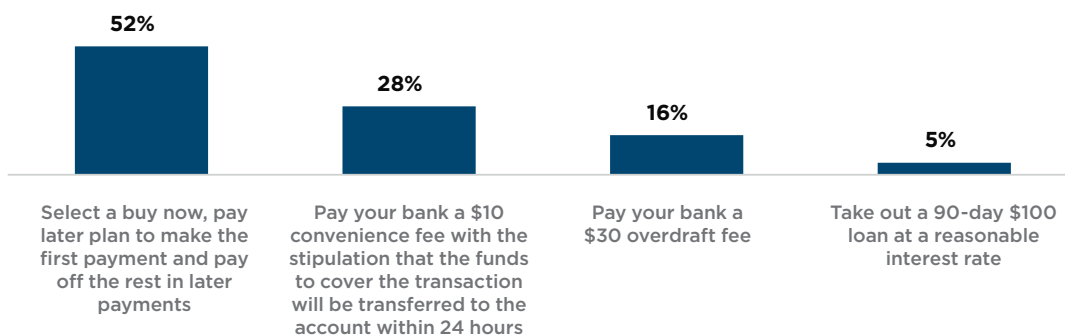
Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

LIQUIDITY CHALLENGES AT THE POINT OF SALE

Liquidity issues can arise at the point of purchase. Survey respondents were asked what they would do if they were buying a \$100 item online with their debit card, and the transaction was denied. Roughly half of consumers would select a buy now, pay later (BNPL) option and nearly three in 10 would pay a \$10 convenience fee to their bank with the expectation that they would cover the funds within 24 hours (Figure 20).

FIGURE 20: Denial of \$100 Online Purchase Transaction

If you were online buying a \$100 item with your debit card, and it was declined because of insufficient funds, which of the following would you do to have the transaction approved?



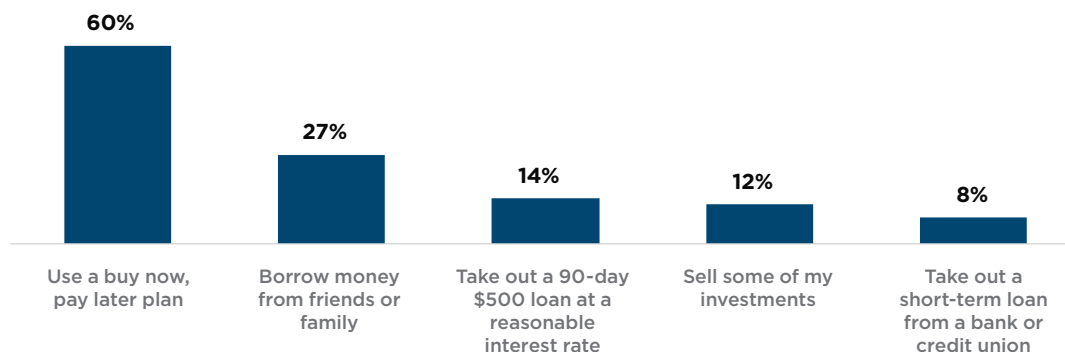
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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

For more expensive purchases, 60% of consumers would opt for a buy now, pay later plan, but 27% would borrow from friends/family, and 14% would turn to the bank for a short-term loan (Figure 21).

FIGURE 21: Denial of \$500 Purchase Transaction

If you were planning on making a \$500 purchase and knew you didn't have the funds in your checking account to cover the purchase, which of the following would you consider doing in order to make the purchase?

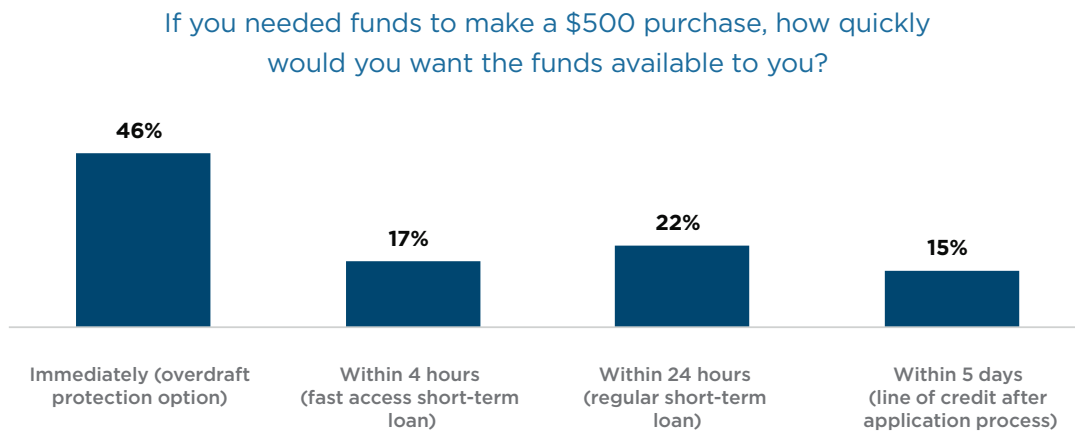


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Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Faced with a \$500 purchase they didn't have available funds for, roughly half of consumers would want the money immediately (the overdraft protection option), but 17% would be willing to wait four hours to get a fast access short-term loan, 22% could wait a day to get a regular short-term loan, and 15% would be OK waiting five days and applying for a line of credit (Figure 22).

FIGURE 22: Preferences for Available Funds

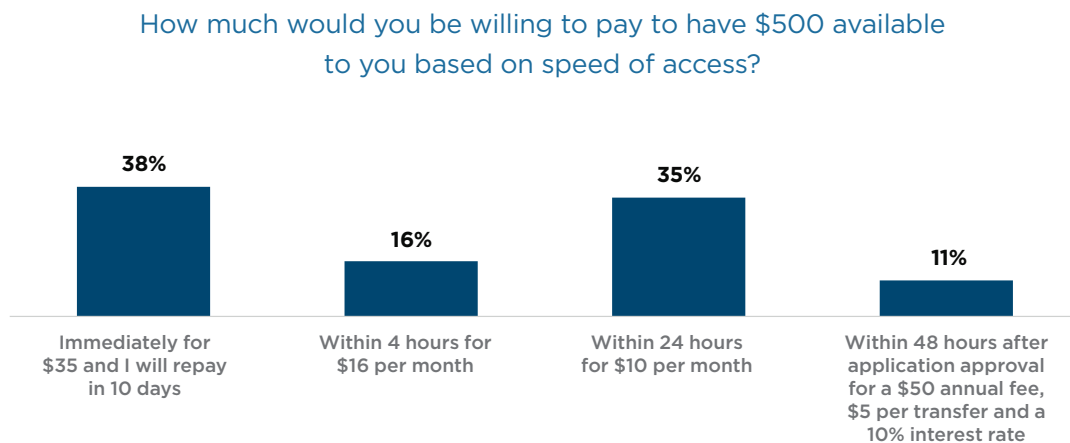


22-1005-22

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

Nearly four in 10 consumers would be willing to pay \$35 to get immediate access to \$500 with repayment within 10 days. Another 35% are willing to pay a \$10 monthly charge to be able to access the \$500 within 24 hours (Figure 23).

FIGURE 23: Willingness to Pay for Available Funds



22-1005-23

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

CONCLUSION:

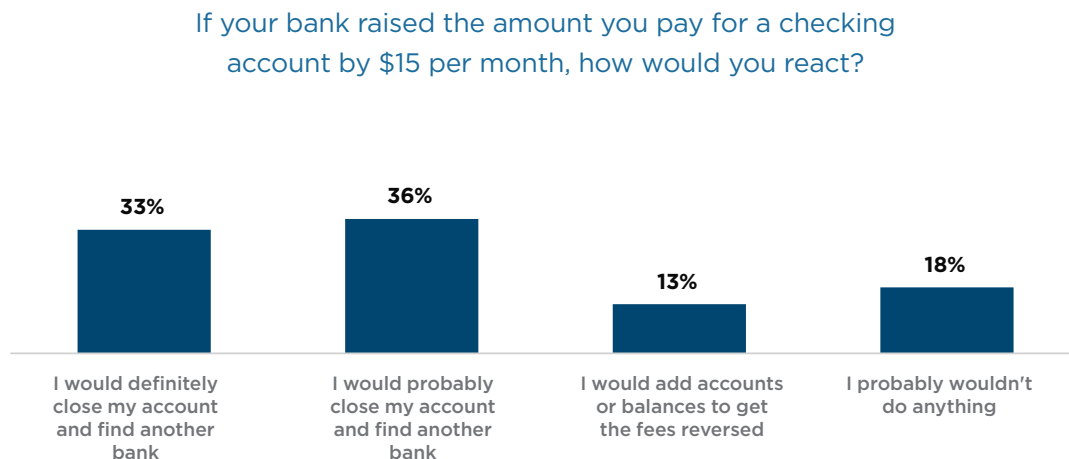
Moving From Overdraft Protection to Liquidity Management

The recent change in many financial institutions' overdraft policies is good news for consumers, and good for financial institutions—from a regulatory and public relations perspective, that is. From a revenue perspective, it's a different story, as many institutions are facing millions of dollars in lost fee income. According to Steven Simpson, senior director at Cornerstone Advisors:

*"News of waiving overdraft fees may sound like another big win for the consumer. However, this issue is not so cut and dried for two important reasons: 1) There will be unintended consequences of new strategies aimed at reducing overdraft fees that consumers and those favoring the trend are not thinking through completely, and 2) The consumer banking model that delivers convenient branches, contact center, digital banking, debit cards, fraud protection limits, cybersecurity, and access to larger amounts of cash needs revenue to sustain itself."*¹

Bankers should recognize that increasing monthly account fees will likely result in lost customers. Nearly seven in 10 customers said they would close their account and find another bank if their bank increased the monthly account fee by \$15 (Figure 24).

FIGURE 24: Reaction to Increased Checking Account Monthly Fee



22-1005-24

Source: Cornerstone Advisors survey of 3,000 U.S. consumers, Q2 2022

¹ <https://gonzobanker.com/2021/08/competitive-shifts-in-overdraft-fees/>

ELIMINATING OVERDRAFT IS NOT THE ANSWER

More than eight in 10 consumers said having overdraft protection is a good thing and they're glad their bank covers transaction when they don't have enough money in their account. In addition, almost half said that not only did they like the service, but they also thought the fees are fair.

The percentage of consumers that find themselves unable to pay monthly bills from time to time underscores the need for liquidity, and the percentage who would resort to taking undesirable actions—like taking out a payday loan, selling belongings at a pawn shop, selling investments, or just not paying the bill at all and incurring a late charge—underscores the importance of overdraft and what happens to real consumers if it's taken away.

Overall, 56% of consumers believe the overdraft protection fees they pay are fair, and roughly four in 10 think the NSF fees their bank or credit union charges are fair.

Simply eliminating fees for overdrafts—and changing how FIs pay out or don't pay out on the attempted consumer payments—doesn't address the root cause of consumers' problems, which is illiquidity.

HELPING CONSUMERS MANAGE LIQUIDITY

To address this problem—and recoup lost millions in fees—banks and credit unions must transform their overdraft programs into liquidity management programs. These programs should:

- **Be proactive and personalized.** A “managed” program assigns overdraft limits based on a variety of account holder data points, including specific deposit and overdraft activity. Institutions should establish a risk profile for each account and assign individualized overdraft limits based on the account holder's ability to repay the overdraft. An “unmanaged” program, on the other hand, provides a “one-size-fits-all” approach that is determined at account opening—for example, all account holders who qualify to be in the program receive the same overdraft limit, or the limit varies based on account type (e.g., \$500 for Free Checking and \$750 for Premier Checking).
- **Emphasize speed.** Consumers like the speed of immediate availability using overdraft, with many saying they would want the overdraft option if they needed funds to make a \$500 purchase (44%, compared to 17%, 22% and 15% for 4-hour fast-access loans, 24-hour regular loans, or 5 days for line of credit applications, respectively).
- **Establish a “de minimis exception.”** A de minimis exception is a minimum overdraft amount below which the institution won't charge a fee. According to Christopher Leonard, CEO of Velocity Solutions, “There are a couple of different ways to provide a de minimis exception: 1) on a per-item basis (e.g., if the item is less than \$5, then no overdraft fee is charged), or 2) on a per-day basis (e.g., if the account is overdrawn by less than \$10 at the end of the day, then no overdraft fees will be charged that day).” A de minimis waiver policy is a consumer-friendly practice to prevent the “\$30 fee for a \$3 cup of coffee” headline scenario.

- **Use tools that limit overdraft fees for low-income consumers.** Charging \$400 to a consumer who has \$2,000 a month in deposits is not in the best interest of the consumer or the financial institution. Software is available that can reduce usage of the overdraft service (and the associated fees) when fees exceed a given percentage of the consumer's deposits.
- **Provide a variety of credit alternatives.** According to an estimate from Cornerstone Advisors, Americans made \$100 billion in buy now, pay later purchases in 2021. Banks and credit unions have scrambled to replace the interchange lost from these purchases, but the bigger issue may be the erosion of the consumer relationship due to other providers offering credit at the consumer's point of need. Financial institutions' liquidity management programs should offer a range of credit alternatives including BNPL and referrals to providers who can offer small-dollar short-term loans.






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Ron Shevlin heads up Cornerstone Advisors' fintech research efforts and authors many of the firm's studies. He has been a management consultant for more than 30 years, working with leading financial services, consumer products, retail, and manufacturing firms worldwide. Prior to joining Cornerstone, Ron was a researcher and consultant for Aite Group, Forrester Research, and KPMG. Author of the Fintech Snark Tank blog on Forbes, Ron is ranked among the top fintech influencers globally and is a frequent keynote speaker at banking and fintech industry events.

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ABOUT

CORNERSTONE ADVISORS



At Cornerstone Advisors, our goal is to deliver tangible business impact to financial institutions. We know that when institutions improve their strategies, technology, and operations, enhanced financial performance naturally follows. Because we live by the philosophy that businesses can't improve what they don't measure, we show banks and credit unions how to use laser-focused measurement to make smarter technology decisions, reengineer critical processes, and develop more meaningful business strategies.

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VELOCITY SOLUTIONS



Founded in 1995 and servicing the transaction accounts of over 30 million consumers and business owners, Velocity Solutions is the leading provider of technology solutions that drive revenue, service and compliance for community banks and credit unions. Our Velocity Intelligent Platform® powers all of Velocity's solutions, using machine-led intelligence that delivers powerful analytics, manages risk, and drives revenue, loans, account holder engagement and non-interest income to our client financial institutions.

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